CITY OF EARLHAM

INDEPENDENT AUDITOR'S REPORTS BASIC FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION SCHEDULE OF FINDINGS

JUNE 30, 2011

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Officials

<u>Name</u>	<u>Title</u>	
Ron TeKippe	Mayor	Jan 2012
Scott Petersen	Mayor Pro tem	Jan 2012
Jeff Lillie Mike Golightly David Hollander Jamie Royster	Council Member Council Member Council Member Council Member	Jan 2012 Jan 2014 Jan 2014 Jan 2014
Linette Crouch	Clerk/Treasurer	Indefinite
Dean Nelson	Attorney	Indefinite



Independent Auditor's Report

To the Honorable Mayor and Members of the City Council:

We have audited the accompanying financial statements of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Earlham, Iowa, as of and for the year ended June 30, 2011, which collectively comprise the City's basic financial statements listed in the table of contents. These financial statements are the responsibility of the City of Earlham's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in <u>Government Auditing Standards</u>, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinions.

As described in Note 1, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles. Also, as permitted by the Code of Iowa, the accounting records of the City were not audited from July 1, 2009 to June 30, 2010. Accordingly, we were unable to satisfy ourselves as to the distribution by fund of the total fund balance at July 1, 2010.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to verify the distribution by fund of the total fund balance at July 1, 2010, as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the respective cash basis financial position of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Earlham as of June 30, 2011, and the respective changes in cash basis financial position for the year then ended in conformity with the basis of accounting described in Note 1.

In accordance with <u>Government Auditing Standards</u>, we have also issued our report dated November 3, 2011 on our consideration of the City of Earlham's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with <u>Government Auditing Standards</u> and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 7 through 12 and 30 through 32 are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Earlham's basic financial statements. Other supplementary information included in Schedules 1 through 3 is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to verify the distribution by fund of the total fund balance at July 1, 2010, as discussed in the third paragraph, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Short & Company, CAA, P.L.C.

November 3, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

The City of Earlham provides this Management's Discussion and Analysis of its financial statements. This narrative overview and analysis of the financial activities is for the fiscal year ended June 30, 2011. We encourage readers to consider this information in conjunction with the City's financial statements, which follow.

Because the City is not required to be audited annually, much of the information is not easily comparable to prior years. Comparative data has been provided if available.

2011 FINANCIAL HIGHLIGHTS

- The cash basis net assets of the City's governmental activities increased approximately \$61,000. There was an increase in the general fund cash basis net assets due to revenues collected exceeding expenditures.
- The cash basis net assets of the City's business type activities decreased approximately \$71,000. The decrease is due to business type disbursements and debt service disbursements exceeding revenues collected.

USING THIS ANNUAL REPORT

The annual report consists of a series of financial statements and other information as follows:

Management's Discussion and Analysis introduces the basic financial statements and provides an analytical overview of the City's financial activities.

The Government-wide Financial Statement consists of a Statement of Activities and Net Assets. This statement provides information about the activities of the City as a whole and presents an overall view of the City's finances.

The Fund Financial Statements tell how governmental services were financed in the short term as well as what remains for future spending. Fund financial statements report the City's operations in more detail than the government-wide statement by providing information about the most significant funds.

Notes to Financial Statements provide additional information essential to a full understanding of the data provided in the basic financial statements.

Required Supplementary Information further explains and supports the financial statements with a comparison of the City's budget for the year.

Other Supplementary Information provides detailed information about the nonmajor governmental funds and the City's indebtedness.

BASIS OF ACCOUNTING

The City maintains its financial records on the basis of cash receipts and disbursements and the financial statements of the City are prepared on that basis. The cash basis of accounting does not give effect to accounts receivable, accounts payable and accrued items. Accordingly, the financial statements do not present financial position and results of operations of the funds in accordance with U.S. generally accepted accounting principles. Therefore, when reviewing the financial information and discussion within this annual report, the reader should keep in mind the limitations resulting from the use of the cash basis of accounting.

REPORTING THE CITY'S FINANCIAL ACTIVITIES

Government-wide Financial Statement

One of the most important questions asked about the City's finances is, "Is the City as a whole better off or worse off as a result of the year's activities?" The Statement of Activities and Net Assets reports information which helps answer this question.

The Statement of Activities and Net Assets presents the City's net assets. Over time, increases or decreases in the City's net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The Statement of Activities and Net Assets is divided into two kinds of activities:

- Governmental Activities include public safety, public works, culture and recreation, community and economic development, general government, debt service and capital projects. Property tax and state and federal grants finance most of these activities.
- Business Type Activities include the waterworks and the sanitary sewer system as well as the community building. These activities are financed primarily by user charges.

Fund Financial Statements

The City has two kinds of funds:

1) Governmental funds account for most of the City's basic services. These focus on how money flows into and out of those funds and the balances at year-end that are available for spending. The governmental funds include: 1) the General Fund, 2) the Special Revenue Funds, such as Road Use Tax and Local Option Sales Tax, 3) the Debt Service Fund, 4) the Capital Projects Fund and 5) the Permanent Funds. The governmental fund financial statements provide a detailed, short-term view of the City's general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs.

The required financial statement for governmental funds is a statement of cash receipts, disbursements and changes in cash balances.

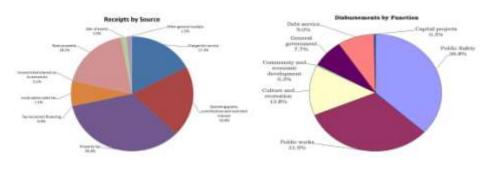
2) Proprietary funds account for the City's Enterprise Funds. Enterprise Funds are used to report business type activities. The City maintains three Enterprise Funds to provide separate information for the Water, Sewer and Community Building funds, considered to be major funds of the City.

The required financial statement for proprietary funds is a statement of cash receipts, disbursements and changes in cash balances.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of financial position. The City's cash balance for governmental activities increased from a year ago, increasing from \$568,758 to \$630,237. The analysis that follows focuses on the changes in cash basis net assets for governmental activities.

	Ye	ar ended
	June 30,	
		2011
Receipts:		
Program receipts:		
Charges for service	\$	224,206
Operating grants, contributions and restricted interest		257,169
General receipts:		
Property tax		445,254
Tax increment financing		357
Local option sales tax		91,677
Unrestricted interest on investments		1,536
Note proceeds		236,186
Sale of assets		20,000
Other general receipts		18,921
Total receipts		1,295,306
Disbursements:		
Public safety		454,051
Public works		394,055
Culture and recreation		170,883
Community and economic development		4,012
General government		95,181
Debt service		111,451
Capital projects		4,194
Total disbursements		1,233,827
Increase in cash basis net assets		61,479
Cash basis net assets beginning of year		568,758
Cash basis net assets end of year	\$	630,237



The cash basis net assets of the City's governmental funds increased \$61,479. There was an increase in the general fund cash basis net assets due to revenues collected exceeding expenditures.

Changes in Cash Basis Net Assets of Business Type Activities				
Year ende				
	J	June 30,		
		2011		
Receipts:				
Program receipts:				
Charges for service:				
Water	\$	298,611		
Sewer		213,950		
Community building		21,628		
General receipts:				
Unrestricted interest on investments		1,605		
Other general receipts		1,755		
Total receipts		537,549		
Disbursements:				
Water		351,190		
Sewer		240,847		
Community building		16,938		
Total disbursements		608,975		
Decrease in cash basis net assets		(71,426)		
Cash basis net assets beginning of year		745,894		
Cash basis net assets end of year	\$	674,468		

The cash basis net assets of the City's business type activities decreased 9.6%, or \$71,426, due primarily to disbursements exceeding collections.

INDIVIDUAL MAJOR GOVERNMENTAL FUND ANALYSIS

As the City of Earlham completed the year, its governmental funds reported a combined fund balance of \$630,237, an increase of \$61,479 above last year's total of \$568,758. The following are the major reasons for the changes in fund balances of the major funds from the prior year.

- The General Fund cash balance increased \$68,095 to \$248,543 during the fiscal year. The increase is due primarily to reduction in spending by various departments.
- The Special Revenue, Road Use Tax Fund cash balance decreased \$85,732 to negative \$31,993 during the fiscal year. This decrease was attributable to street projects and capital purchases in fiscal year 2011.

- The Special Revenue, Local Option Sales Tax Fund cash balance decreased \$24,654 during the fiscal year. The Council designated several capital projects in FY2011 to be funded by the local option sales tax fund.
- The Capital Projects cash balance increased \$38,973 to (\$253,158) during the fiscal year. The increase is due to the continuance of collecting special assessments for completed projects and transferring funds from local option sales tax fund as designated by special resolution of the Council.
- The Permanent, Hoadley Library Trust Fund was established to account for a bequest received by the Earlham Public Library. At the end of the fiscal year, the cash balance was \$417,604, an increase of \$3,023 over the previous year. Transfers from the Trust Fund to the Library operating fund (general fund) remained relatively the same as the prior year.
- The Permanent, Cemetery Perpetual Care Fund cash balance increased \$2,093 to \$79,389 during the fiscal year. The increase is not significant.

INDIVIDUAL MAJOR BUSINESS TYPE FUND ANALYSIS

- The Enterprise, Water Fund cash balance decreased by \$49,798 to \$297,736, due primarily to a significant capital project to repair and replace water lines.
- The Enterprise, Sewer Fund cash balance decreased by \$26,318 to \$371,142 during the fiscal year. The decrease in cash balance is primarily due to a significant project to maintain sewer lines.
- The Enterprise, Community Building cash balance increased by \$4,690 to \$5,590 during the fiscal year. The increase is due to user fees exceeding cost of operations of the facility.

BUDGETARY HIGHLIGHTS

Over the course of the year, the City amended its budget three times. The first amendment was approved on August 9, 2010 and resulted in an increase in operating disbursements in three functions of \$52,790 for expenses related to improvements at the recreation park, energy efficient upgrades to city hall, street repairs that were not completed in the previous fiscal year and correction for omission of wages for the recreation park. The second amendment was approved January 10, 2011 to provide for the hiring of a new police officer and additional street repairs. The third amendment was approved May 9, 2011 increasing expenses by \$31,200 in three functions. The increase was due to an increase in police wages, replacement of heater at the city pool and other capital projects.

The City's receipts were \$35,458 more than budgeted receipts. This was primarily due to a significant amount of miscellaneous receipts.

Total disbursements were \$181,372 less than budgeted for all activities. Despite three budget amendments, the debt service function exceeded budget by \$64. The actual disbursements for the public safety, public works, culture and recreation, community and economic development, general government, capital projects and business type activities functions were \$23,700, \$18,382, \$66,242, \$5,288, \$11,637, \$6 and \$56,181, less than the amended budget.

The debt service budget was exceeded due to unbudgeted bond expenses.

DEBT ADMINISTRATION

At June 30, 2011, the City had \$2,574,279 in notes and other long-term debt outstanding, compared to \$2,532,437 last year, as shown below:

Outstanding Debt at Year-End						
	June 30,					
	2011	2010				
General obligation capital loan notes	\$ 686,181	525,000				
Revenue notes	847,000	912,000				
Water service agreement	1,038,839	1,053,201				
Lease-purchase agreements	-	20,113				
Installment-purchase agreements	2,259	22,123				
Total	\$2,574,279	2,532,437				

Debt increased due to the issuance of a general obligation note to purchase a new fire truck.

The Constitution of the State of Iowa limits the amount of general obligation debt cities can issue to 5% of the assessed value of all taxable property within the City's corporate limits. The City's outstanding general obligation of \$1,727,279 is below its constitutional debt limit of approximately \$3.4 million.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The City of Earlham's elected and appointed officials and citizens considered many factors when setting the fiscal year 2012 budget, tax rates, and fees charged for various City activities. One of these factors is deficit balances in the road use tax, debt service and capital project funds.

These factors were taken into account when adopting the budget for fiscal year 2012. Amounts available for appropriation in the operating budget are \$1,486,123, a decrease of 25.6% under the final 2011 budget. The 2012 budgeted revenues reflect an anticipated increase of \$23,000 in property tax revenue.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Linette Crouch, City Clerk, 140 S. Chestnut, Earlham, Iowa 50072.



Statement of Activities and Net Assets - Cash Basis

As of and for the year ended June 30, 2011

			Program Receipts			
				Operating Grants, Contributions		
			Charges for	and Restricted		
	Disl	oursements	Service	Interest		
Governmental activities:						
Public safety	\$	454,051	3,274	80,642		
Public works		394,055	127,174	129,069		
Culture and recreation		170,883	39,832	47,458		
Community and economic development		4,012	200	=		
General government		95,181	20,680	=		
Debt service		111,451	-	-		
Capital projects		4,194	33,046	-		
Total governmental activities		1,233,827	224,206	257,169		
Business type activities:						
Water		351,190	298,611	=		
Sewer		240,847	213,950	-		
Community building		16,938	21,628	-		
Total business type activities		608,975	534,189	-		
Total	\$	1,842,802	758,395	257,169		

General Receipts:

Property and other city tax levied for:

General purposes

Debt service

Tax increment financing

Local option sales tax

Unrestricted interest on investments

Note proceeds

Miscellaneous

Sale of assets

Total general receipts

Change in cash basis net assets

Cash basis net assets beginning of year

Cash basis net assets end of year

Cash Basis Net Assets

Restricted:

Nonexpendable:

Hoadley library trust

Cemetery perpetual care

Expendable:

Urban renewal purposes

Debt service

Capital improvements and other purposes

Other purposes

Unrestricted

Total cash basis net assets

See notes to financial statements.

Net (Disbursements) Receipts and Changes in Cash Basis Net Assets

_			
	vernmental	Business Type	m-4-1
	Activities	Activities	Total
	(370,135)	-	(370,135)
	(137,812)	-	(137,812)
	(83,593)	-	(83,593)
	(3,812)	-	(3,812)
	(74,501)	-	(74,501)
	(111,451)	-	(111,451)
	28,852	-	28,852
	(752,452)	-	(752,452)
	-	(52,579)	(52,579)
	-	(26,897)	(26,897)
	-	4,690	4,690
	-	(74,786)	(74,786)
	(752,452)	(74,786)	(827,238)
	406,236	-	406,236
	39,018	=	39,018
	357	-	357
	91,677	-	91,677
	1,536	1,605	3,141
	236,186	-	236,186
	18,921	1,755	20,676
	20,000	-	20,000
	813,931	3,360	817,291
	61,479	(71,426)	(9,947)
	568,758	745,894	1,314,652
\$	630,237	674,468	1,304,705
\$	417,604		417,604
Ψ	79,389	_	79,389
	19,569		19,309
	313	-	313
	-	207,544	207,544
	140,271	-	140,271
	153,850	-	153,850
	(161,190)	466,924	305,734
\$	630,237	674,468	1,304,705

Statement of Cash Receipts, Disbursements and Changes in Cash Balances Governmental Funds

As of and for the year ended June 30, 2011

	Special Revenue				
		Road	Local		
		Use	Option	Capital	
	Genera	l Tax	Sales Tax	Projects	
Receipts:					
Property tax	\$ 325,7	57 -	-	-	
Tax increment financing			-	-	
Other city tax			91,677	-	
Licenses and permits	3,3	36 -	-	-	
Use of money and property	4,4	73 -	-	-	
Intergovernmental	68,2	36 122,171		-	
Charges for service	140,6	68 -		-	
Special assessments			-	33,046	
Miscellaneous	26,6	78 -	16,865		
Total receipts	569,1	48 122,171	108,542	33,046	
Disbursements					
Operating:					
Public safety	398,0	51 -	1,166	-	
Public works	166,4	11 161,408	54,238	-	
Culture and recreation	135,6	10 -	17,835	-	
Community and economic development	4,0	12 -	-	-	
General government	65,1	55 -	23,286	-	
Debt service			-	-	
Capital projects			-	4,194	
Total disbursements	769,2	39 161,408	96,525	4,194	
Excess (deficiency) of receipts over (under)	<u> </u>				
disbursements	(200,0	91) (39,237	12,017	28,852	
Other financing sources (uses):					
Note proceeds	236,1	86 -	-	-	
Sale of capital assets	20,0	00 -	-	-	
Operating transfers in	12,0	00 -	-	36,671	
Operating transfers out		- (46,495	(36,671)	(26,550)	
Total other financing sources (uses)	268,1	86 (46,495	(36,671)	10,121	
Net change in cash balances	68,0	95 (85,732	(24,654)	38,973	
Cash balances beginning of year	180,4	48 53,739	164,925	(292,131)	
Cash balances end of year	\$ 248,5	43 (31,993	3) 140,271	(253,158)	
Cash Basis Fund Balances					
Nonspendable -					
Hoadley library trust	\$			_	
Cemetary perpetual care	Ψ			_	
Restricted for:					
Urban renewal purposes				_	
Capital improvements and other purposes			140,271	_	
Other purposes	61,6	49 -		-	
Unassigned	186,8		3) -	(253,158)	
					
Total cash basis fund balances	\$ 248,5	43 (31,993	3) 140,271	(253,158)	

Permar	nent		
Hoadley	Cemetary	-	
Library	Perpetual		
Trust	Care	Nonmajor	Total
Trust	Carc	Nonnajor	Total
_	_	119,497	445,254
_	_	357	357
_	_	-	91,677
			3,336
15,148	293	6,883	26,797
15,146	293	0,003	
-	1 000	-	190,407
-	1,800	-	142,468
-	-	-	33,046
		62,235	105,778
15,148	2,093	188,972	1,039,120
-	-	54,834	454,051
-	-	11,998	394,055
125	-	17,313	170,883
-	-	-	4,012
-	-	6,740	95,181
-	-	111,451	111,451
-	-	-	4,194
125	-	202,336	1,233,827
15,023	2,093	(13,364)	(194,707)
_	_	_	236,186
_	_	_	20,000
_	_	73,045	121,716
(12,000)		70,010	(121,716)
(12,000)		73,045	256,186
	0.002		
3,023	2,093	59,681	61,479
414,581	77,296	(30,100)	568,758
417,604	79,389	29,581	630,237
417,604		-	417,604
-	79,389	-	79,389
-	-	313	313
_	-	_	140,271
_	-	92,201	153,850
		(62,933)	(161,190)
417 604	70 290		
417,604	79,389	29,581	630,237

Statement of Cash Receipts, Disbursements and Changes in Cash Balances Proprietary Funds

As of and for the year ended June 30, 2011

	Enterprise Funds				
	Community				
		Water	Sewer	Building	Total
Operating receipts:					
Charges for service	\$	298,611	213,950	21,628	534,189
Total operating receipts		298,611	213,950	21,628	534,189
Operating disbursements:					
Business type activities		276,382	146,207	16,938	439,527
Excess of operating receipts over operating					
disbursements		22,229	67,743	4,690	94,662
Non-operating receipts (disbursements):					
Interest on investments		1,026	579	-	1,605
Miscellaneous		1,755	-	-	1,755
Debt service		(74,808)	(94,640)	-	(169,448)
Net non-operating receipts (disbursements)		(72,027)	(94,061)		(166,088)
Excess of receipts over disbursements		(49,798)	(26,318)	4,690	(71,426)
Operating transfers out		-	-	-	-
Net change in cash balances		(49,798)	(26,318)	4,690	(71,426)
Cash balances beginning of year		347,534	397,460	900	745,894
Cash balances end of year	\$	297,736	371,142	5,590	674,468
Cash Basis Fund Balances					
Restricted for debt service	\$	55,666	151,878	-	207,544
Unrestricted		242,070	219,264	5,590	466,924
Total cash basis fund balances	\$	297,736	371,142	5,590	674,468

See notes to financial statements.



Notes to Financial Statements

June 30, 2011

(1) Summary of Significant Accounting Policies

The City of Earlham is a political subdivision of the State of Iowa located in Madison County. It was first incorporated in 1870 and operates under the Home Rule provisions of the Constitution of Iowa. The City operates under the Mayor-Council form of government with the Mayor and Council Members elected on a non-partisan basis. The City provides numerous services to citizens, including public safety, public works, culture and recreation, community and economic development, and general government services. The City also provides water and sewer utilities for its citizens.

A. Reporting Entity

For financial reporting purposes, the City of Earlham has included all funds, organizations, agencies, boards, commissions and authorities. The City has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the City's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the City to impose its will on that organization or (2) the potential for the organization to provide specific benefits to or impose specific financial burdens on the City.

These financial statements present the City of Earlham (the primary government) and its component units. The component units discussed below are included in the City's reporting entity because of the significance of their operational or financial relationship with the City.

Blended Component Units

The Earlham Volunteer Fire and Rescue Association(Association) and Friends of Earlham Public Library (Friends) have been incorporated under the provisions of the Revised Iowa Nonprofit Corporation Act, Chapter 504 of the Code of Iowa. The Association receives donations for the benefit of the Earlham Fire Department. These donations are to be used to purchase items which are not included in the City's budget. Friends receives donations for the benefit of the Earlham Library. These donations are used to purchase items which are not included in the City's budget. In accordance with the criteria set forth by the Governmental Accounting Standards Board, the Association and Friends meet the definition of component units which should be blended. The financial activity of the component units have been blended as Special Revenue Funds of the City.

Jointly Governed Organizations

The City participates in several jointly governed organizations that provide goods or services to the citizenry of the City but do not meet the criteria of a joint venture since there is no ongoing financial interest or responsibility by the participating governments. City officials are members of the following boards and

commissions: Madison County Assessor's Conference Board, Madison County Emergency Management Commission and Madison County Joint E911 Service Board.

B. Basis of Presentation

Government-wide Financial Statement - The Statement of Activities and Net Assets reports information on all of the nonfiduciary activities of the City. For the most part, the effect of interfund activity has been removed from this statement. Governmental activities, which are supported by tax and intergovernmental revenues, are reported separately from business type activities, which rely to a significant extent on fees and charges for service.

The Statement of Activities and Net Assets presents the City's nonfiduciary net assets. Net assets are reported in the following categories/components:

Nonexpendable restricted net assets are subject to externally imposed stipulations which require them to be maintained permanently by the City, including the City's Hoadley Library Trust and Cemetary Perpetual Care Funds.

Expendable restricted net assets result when constraints placed on net asset use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets not meeting the definition of the preceding categories. Unrestricted net assets often have constraints on resources imposed by management which can be removed or modified.

The Statement of Activities and Net Assets demonstrates the degree to which the direct disbursements of a given function are offset by program receipts. Direct disbursements are those clearly identifiable with a specific function. Program receipts include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function and 2) grants, contributions and interest on investments restricted to meeting the operational or capital requirements of a particular function. Property tax and other items not properly included among program receipts are reported instead as general receipts.

<u>Fund Financial Statements</u> – Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements. All remaining governmental funds are aggregated and reported as nonmajor governmental funds.

The City reports the following major governmental funds:

The General Fund is the general operating fund of the City. All general tax receipts from general and emergency levies and other receipts not allocated by law or contractual agreement to some other fund are accounted for in this fund. From the fund are paid the general operating disbursements, the fixed charges and the capital improvement costs not paid from other funds.

Special Revenue:

The Road Use Tax Fund is used to account for the road use tax allocation from the State of Iowa to be used for road construction and maintenance.

The Local Option Sales Tax Fund is used to account for the revenues from the tax authorized by referendum and used for capital improvement projects as determined by the council.

The Capital Projects Fund is used to account for all resources used in the acquisition and construction of capital facilities.

Permanent:

The Hoadley Library Trust Fund is utilized to account for resources held by the City which are legally restricted.

The Cemetery Perpetual Care Fund is utilized to account for resources that are legally restricted to where only the earnings, and not the principal, may be used for purposes of maintaining the City's cemetery.

The City reports the following major proprietary funds:

The Enterprise, Water Fund accounts for the operation and maintenance of the City's water system.

The Enterprise, Sewer Fund accounts for the operation and maintenance of the City's wastewater treatment and sanitary sewer system.

The Enterprise, Community Building Fund accounts for the operation and maintenance of the City's community building.

C. Measurement Focus and Basis of Accounting

The City maintains its financial records on the basis of cash receipts and disbursements and the financial statements of the City are prepared on that basis. The cash basis of accounting does not give effect to accounts receivable, accounts payable and accrued items. Accordingly, the financial statements do not present financial position and results of operations of the funds in accordance with U.S. generally accepted accounting principles.

Under the terms of grant agreements, the City funds certain programs by a combination of specific cost-reimbursement grants, categorical block grants and general receipts. Thus, when program disbursements are paid, there are both restricted and unrestricted cash basis net assets available to finance the program. It is the City's policy to first apply cost-reimbursement grant resources to such programs, followed by categorical block grants and then by general receipts.

When a disbursement in governmental funds can be paid using either restricted or unrestricted resources, the City's policy is generally to first apply the disbursement toward restricted fund balance and then to less-restrictive classifications – committed, assigned and then unassigned fund balances.

Proprietary funds distinguish operating receipts and disbursements from non-operating items. Operating receipts and disbursements generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All receipts and disbursements not meeting this definition are reported as non-operating receipts and disbursements.

D. Governmental Cash Basis Fund Balances

In the governmental fund financial statements, cash basis fund balances are classified as follows:

<u>Nonspendable</u> – Amounts which cannot be spent because they are legally or contractually required to be maintained intact.

<u>Restricted</u> – Amounts restricted to specific purposes when constraints placed on the use of the resources are either externally imposed by creditors, grantors, or state or federal laws or imposed by law through constitutional provisions or enabling legislation.

<u>Assigned</u> – Amounts the Council intends to use for specific purposes.

<u>Unassigned</u> – All amounts not included in other spendable classifications.

E. Budgets and Budgetary Accounting

The budgetary comparison and related disclosures are reported as Required Supplementary Information.

(2) Cash and Pooled Investments

The City's deposits in banks at June 30, 2011 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The City is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the City Council; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

At June 30, 2011, the Hoadley Library Trust Fund had the following investments:

	Carrying	Fair	
Туре	Amount	Value	Maturity
Common Stock	\$ 93,743	\$ 209,143	N/A

The disclosures for concentration of credit risk, credit risk and interest rate risk are not applicable.

(3) Notes and Water Service Agreement Payable

Annual debt service requirements to maturity for general obligation notes, sewer revenue notes and water service agreement are as follows:

Year	(General Ol	oligation	Sev	ver	Wat	er		
Ending		Notes		Revenue Notes		Service Agreement		To	tal
June 30,	F	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2012	\$	107,845	31,060	66,000	25,410	15,115	52,889	188,960	109,359
2013		116,017	24,703	68,000	23,430	15,908	52,096	199,925	100,229
2014		117,413	19,860	70,000	21,390	16,743	51,261	204,156	92,511
2015		123,872	14,901	73,000	19,290	17,622	50,382	214,494	84,573
2016		90,396	9,617	75,000	17,100	18,546	49,458	183,942	76,175
2017-2021		130,643	7,453	406,000	50,670	108,391	231,629	645,034	289,752
2022-2026		-	-	89,000	2,670	139,973	200,047	228,973	202,717
2027-2031		-	-	-	-	180,756	159,264	180,756	159,264
2032-2036		-	-	-	-	233,425	106,595	233,425	106,595
2037-2041		-	-	-	-	292,360	38,544	292,360	38,544
Total	\$	686,186	107,594	847,000	159,960	1,038,839	992,165	2,572,025	1,259,719

The Code of Iowa requires principal and interest on general obligation bonds to be paid from the Debt Service Fund. However, \$21,265 of general obligation bond principal and \$6,946 of general obligation bond interest was paid from Enterprise, Water Fund during the year ended June 30, 2011.

Revenue Notes

The City has pledged future sewer customer receipts, net of specified operating disbursements to repay \$1,200,000 of sewer revenue notes issued October 2001 and \$250,000 of sewer revenue notes issued June 2002. Proceeds from the notes provided financing of upgrades to the existing wastewater treatment lagoons. The notes are payable solely from sewer customer net receipts and are payable through 2022. The total principal and interest remaining to be paid on the notes is \$1,006,960. For the current year, principal and interest paid and total customer net receipts were \$92,360 and \$67,743, respectively.

The resolutions providing for the issuance of the sewer revenue notes include the following provisions.

- (a) The notes will only be redeemed from the future earnings of the enterprise activity and the note holders hold a lien on the future earnings of the fund.
- (b) Sufficient monthly transfers shall be made to a separate sewer revenue note sinking account within the Enterprise for the purpose of making the note principal and interest payments when due.
- (c) Additional monthly transfers of 25% of the sinking account requirements to a sewer reserve account within the Enterprise Funds shall be made until specific minimum balances have been accumulated. These accounts are restricted for the purpose of paying for additional improvements, extensions or repairs of the system.

Water Service Agreement

The Warren Water District has entered into a loan with the USDA to construct a water supply distribution system. The City has entered into a water service agreement with the Warren Water District to purchase 345,000 gallons per day and pay a fee for connection to the system. The City owns capacity in the water line, is responsible for a portion of the loan and makes monthly payments to the Warren Water District.

During the year ended June 30, 2011, the City made monthly payments of \$5,667 to the Warren Water District for a total of \$68,004, of which \$53,642 was interest and \$14,362 was principal. The City also paid \$567 per month to the Warren Water District as a contribution to the reserve fund maintained by the District. The balance due on this agreement at June 30, 2011 is \$1,038,839.

(4) Lease Purchase Agreements

The City entered into a lease purchase agreement to lease a fire pumper truck. Payment under the lease purchase agreement during the year ended June 30, 2011 totaled \$21,253 from the Debt Service Fund. The lease purchase is paid in full.

(5) Installment Purchase Agreements

The City entered into two installment purchase agreements to purchase a police vehicle and street sweeper. The following is a schedule of the future maturities as of June 30, 2011:

Year Ending	Installment
June 30,	Purchases
2012	2,405
Total	\$ 2,405

(6) Pension and Retirement Benefits

The City contributes to the Iowa Public Employees Retirement System (IPERS), which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by state statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa 50306-9117.

Most regular plan members are required to contribute 4.50% of their annual covered salary and the City is required to contribute 6.95% of covered salary. Certain employees in special risk occupations and the City contribute an actuarially determined contribution rate. Contribution requirements are established by state statute. The City's contributions to IPERS for the year ended June 30, 2011 was \$18,535 equal to the required contribution for the year.

(7) Other Postemployment Benefits (OPEB)

<u>Plan Description</u> – The City operates a single-employer health benefit plan which provides medical/prescription drug benefits for employees and retirees and their spouses. There are 6 active members in the plan. Retired participants must be age 55 or older at retirement and pay full premium for their coverage.

The medical/prescription drug benefits are provided through a fully-insured plan with United HealthCare. Premiums under the program are age-based for all participants.

<u>Funding Policy</u> – The contribution requirements of plan members are established and may be amended by the City. The City currently finances the benefit plan on a pay-as-you-go basis. The City pays 100% for single coverage with age-based premiums ranging from \$249 per month to \$367 per month. For the year ended June 30, 2011, the City contributed \$27,580. All employees have elected single coverage and there were no required employee contributions in fiscal year 2011.

(8) Compensated Absences

City employees accumulate a limited amount of earned but unused paid time off and compensatory time for subsequent use or for payment upon termination, retirement or death. These accumulations are not recognized as disbursements by the City until used or paid. The City's approximate liability for earned paid time off and compensatory time payable to employees at June 30, 2011, primarily relating to the General Fund, is as follows:

Type of Benefit	Amount
Paid time off Compensatory time	\$ 15,572 12
Total	\$ 15,584

This liability has been computed based on rates of pay in effect at June 30, 2011.

(9) Interfund Transfers

The detail of interfund transfers for the year ended June 30, 2011 is as follows:

Transfer to	Transfer from	F	Amount
General	Permanent: Hoadley Library Trust	\$	12,000
Capital Projects	Special Revenue: Local Option Sales Tax		36,671
Debt Service	Capital Projects Special Revenue:		26,550
	Road Use Tax		46,495
			73,045
Total		\$	121,716

Transfers generally move resources from the fund statutorily required to collect the resources to the fund statutorily required to disburse the resources.

(10) Related Party Transactions

The City had business transactions between the City and City officials totaling \$34,795 during the year ended June 30, 2011.

(11) Risk Management

The City is exposed to various risks of loss related to torts; theft, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by the purchase of commercial insurance. The City assumes liability for any deductibles and claims in excess of coverage limitations. Settled claims from these risks did not exceed commercial insurance coverage for the year ended June 30, 2011.

(12) Deficit Balances

The Road Use Tax, Capital Projects, and Debt Service Funds had deficit balances of \$31,993, \$253,158, and \$62,933 at June 30, 2011. The Road Use Tax and Debt Service Fund deficits will be eliminated with future revenues. The City has designated a percentage of annual local option sales tax collections to be used to eliminate the Capital Projects Fund deficit.

(13) Special Investigation

Short and Company, CPA performed a special investigation of the Earlham Volunteer Fire and Rescue Association (blended component unit) for the period January 1, 2004 through April 30, 2011. The special investigation report, dated September 7, 2011, identified \$36,245.10 of improper disbursements and undeposited collections for the period January 1, 2004 through April 30, 2011 of which \$7,972.14 pertained to the year ended June 30, 2011.

Copies of the special investigation report have been filed with the Madison County Attorney's Office, the Division of Criminal Investigation, the Attorney General's Office and the Iowa Office of Auditor of State. A copy of the report is available for review in the Office of Auditor of State.



Budgetary Comparison Schedule of Receipts, Disbursements, and Changes in Balances -Budget and Actual (Cash Basis) – All Governmental Funds and Proprietary Funds

Required Supplementary Information

Year ended June 30, 2011

				Less
	Go	vermental	Proprietary	Funds not
		Funds	Funds	Required to
		Actual	Actual	be Budgeted
Receipts:				
Property tax	\$	445,254	-	-
Tax increment financing		357	-	-
Other city tax		91,677	-	-
Licenses and permits		3,336	-	-
Use of money and property		26,797	1,605	83
Intergovernmental		190,407	-	-
Charges for service		142,468	534,189	-
Special assessments		33,046	-	-
Miscellaneous		105,778	1,755	49,374
Total receipts		1,039,120	537,549	49,457
Dishamon marks				
Disbursements:		454.051		04.624
Public safety		454,051	-	24,634
Public works		394,055	-	1 001
Culture and recreation		170,883	-	1,881
Community and economic development		4,012	-	-
General government		95,181	-	-
Debt service		111,451	-	_
Capital projects		4,194	-	-
Business type activities		-	608,975	
Total disbursements		1,233,827	608,975	26,515
Excess (deficiency)of receipts				
over (under) disbursements		(194,707)	(71,426)	22,942
Other financing sources (uses), net		256,186	-	
Excess (deficiency) of receipts and other				
financing sources over (under)				
disbursements and other financing uses		61,479	(71,426)	22,942
Balances beginning of year		568,758	745,894	36,120
Balances end of year	\$	630,237	674,468	59,062

			Final to
_	Budgeted Ar	Total	
Total	Original	Final	Variance
445,254	428,848	428,848	16,406
357	-	-	357
91,677	93,374	103,374	(11,697)
3,336	6,870	6,870	(3,534)
28,319	23,157	43,157	(14,838)
190,407	170,546	193,177	(2,770)
676,657	668,210	668,210	8,447
33,046	33,784	33,784	(738)
58,159	8,100	14,334	43,825
1,527,212	1,432,889	1,491,754	35,458
429,417	439,117	453,117	23,700
394,055	351,287	412,437	18,382
169,002	205,454	235,244	66,242
4,012	9,300	9,300	5,288
95,181	80,818	106,818	11,637
111,451	111,387	111,387	(64)
4,194	-	4,200	6
608,975	665,156	665,156	56,181
1,816,287	1,862,519	1,997,659	181,372
(289,075)	(429,630)	(505,905)	216,830
256,186	236,186	236,186	20,000
(32,889)	(193,444)	(269,719)	236,830
1,278,532	695,707	802,118	476,414
1,245,643	502,263	532,399	713,244

Notes to Required Supplementary Information - Budgetary Reporting

June 30, 2011

The budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for the General Fund and each major Special Revenue Fund.

In accordance with the Code of Iowa, the City Council annually adopts a budget on the cash basis following required public notice and hearing for all funds except the blended component units. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures.

Formal and legal budgetary control is based upon nine major classes of disbursements known as functions, not by fund. These nine functions are: public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects and business type activities. Function disbursements required to be budgeted include disbursements for the General Fund, the Special Revenue Funds, the Debt Service Fund, the Capital Projects Fund, the Permanent Funds and the Enterprise Funds. Although the budget document presents function disbursements by fund, the legal level of control is at the aggregated function level, not by fund. During the year, three budget amendments increased budgeted disbursements by \$135,140. The budget amendments are reflected in the final budgeted amounts.

During the year ended June 30, 2011, disbursements exceeded the amounts budgeted in the debt service function.



Schedule of Cash Receipts, Disbursements and Changes in Cash Balances Nonmajor Governmental Funds

As of and for the year ended June 30, 2011

		Special Rev	enue	
	Urban	Volunteer		Early
	Renewal Tax	Fire and Rescue	Employee	Out
	Increment	Association	Benefits	Benefits
Receipts				
Property tax	\$ -	-	80,479	-
Tax increment financing	357	-	-	-
Use of money and property	-	70	-	-
Miscellaneous	200	37,618	12,659	<u>-</u> _
Total receipts	557	37,688	93,138	
Disbursements:				
Operating:				
Public safety	-	24,634	30,200	-
Public works	-	-	11,998	-
Culture and recreation	-	-	9,938	-
General government	-	-	6,702	38
Debt service	-	-	-	-
Total disbursements		24,634	58,838	38
Excess (deficiency) of receipts over				
(under) disbursements	557	13,054	34,300	(38)
Other financing uses:				
Operating transfers in		-	-	
Total other financing sources(uses)	-	-	-	-
Net change in cash balances	557	13,054	34,300	(38)
Cash balances beginning of year	(244)	32,044	(4,856)	38
Cash balances end of year	\$ 313	45,098	29,444	
Cash Basis Fund Balances				
Restricted for:	ф. 212			
Urban renewal purposes	\$ 313	-	-	-
Other purposes	-	45,098	29,444	-
Unassigned			-	
Total cash basis fund balances	\$ 313	45,098	29,444	

Friends			
of	Gendler	Debt	
Library	Park	Service	Total
-	-	39,018	119,497
-	-	-	357
13	6,800	-	6,883
11,756		2	62,235
11,769	6,800	39,020	188,972
			54.004
-	-	-	54,834
-	-	-	11,998
1,881	5,494	-	17,313
-	-	-	6,740
		111,451	111,451
1,881	5,494	111,451	202,336
0.000	1 206	(70.401)	(10.064)
9,888	1,306	(72,431)	(13,364)
-	-	73,045	73,045
_	-	73,045	73,045
9,888	1,306	614	59,681
4.076	2 200	(60.547)	(20.100)
4,076	2,389	(63,547)	(30,100)
13,964	3,695	(62,933)	29,581
-	-	-	313
13,964	3,695	-	92,201
		(62,933)	(62,933)
13,964	3,695	(62,933)	29,581
- /	- /	· ·/ /	- ,

Schedule of Indebtedness

Year ended June 30, 2011

			Amount
	Date of	Interest	Originally
Obligation	Issue	Rates	Issued
General obligation notes:			
Street and sidewalk improvements	Nov 15, 2004	2.70 - 4.15%	\$ 295,000
Street, water and sanitary sewer improvement	Aug 11, 2008	4.20%	390,000
Fire truck	October 2, 2010	4.50%	236,181
Total			:
Revenue notes:			
Sewer	Oct 22, 2001	3.00%	\$ 1,200,000
Sewer	Jun 25, 2002	3.00%	250,000
Total			
Water service agreement:			
Warren Water District	Jul 10, 2000	5.125%	\$ 1,154,167
Lease-purchase agreements:			
Fire truck	Apr 23, 2002	5.50%	\$ 132,201
Installment-purchase agreements:			
Police explorer	Nov 28, 2008	6.50%	19,076
Street sweeper	Apr 27, 2009	6.20%	28,339
Total			

Bala	ınce	Issued	Redeemed	Balance	
Begin	ning	During	During	End of	Interest
of Y	ear	Year	Year	Year	Paid
	5,000	-	30,000	145,000	6,753
35	0,000	-	45,000	305,000	14,700
	-	236,181	-	236,181	
\$ 52	5,000	236,181	75,000	686,181	21,453
80	3,000	-	57,000	746,000	24,090
10	9,000	-	8,000	101,000	3,270
\$ 91	2,000	-	65,000	847,000	27,360
1,05	3,201	-	14,362	1,038,839	53,642
2	0,113	-	20,113	-	1,140
	8,224	-	5,965	2,259	535
1	3,899	-	13,899	-	876
\$ 2	2,123	-	19,864	2,259	1,411

Note and Water Service Agreement Maturities

June 30, 2011

		Gene	ral Obligation	Notes		
			Street, W	Vater, and		
	Street and	d Sidewalk	Sanitar	ry Sewer		
	Improv	ements	Improv	rements	Fire Tr	ruck
Year	Issued No	v. 15, 2004	Issued Au	g. 11, 2008	Issued Oct	. 2, 2010
Ending	Interest		Interest		Interest	
June 30,	Rates	Amount	Rates	Amount	Rates	Amount
2012	3.70 %	\$ 35,000	4.20 %	\$ 45,000	4.50 %	\$ 27,845
2013	3.85	35,000	4.20	50,000	4.50	31,017
2014	4.00	35,000	4.20	50,000	4.50	32,413
2015	4.15	40,000	4.20	50,000	4.50	33,872
2016		-	4.20	55,000	4.50	35,396
2017		-	4.20	55,000	4.50	36,989
2018		-		-	4.50	38,654
2019		-		-		-
2020		-		-		-
2021		-		-		-
2022		-		-		-
2023		-		-		-
2024		-		-		-
2025		-		-		-
2026		-		-		-
2027		-		-		-
2028		-		-		-
2029		-		-		-
2030		-		-		-
2031		-		-		-
2032		-		-		-
2033		-		-		-
2034		-		-		-
2035		-		-		-
2036		-		-		-
2037		-		-		-
2038		-		-		-
2039		-		-		_
2040		-		-		_
2041		-		-		-
Total		\$ 145,000		\$ 305,000		\$ 236,186

	Sewer Revenue Notes			Water Service	ce Agreement
Issued Oct.	Issued Oct. 22, 2001 Issued June 25, 2002		25, 2002	Issued Ju	ly 10, 2000
Interest		Interest	_	Interest	
Rates	Amount	Rates	Amount	Rates	Amount
3.00 %	\$ 58,000	3.00 %	\$ 8,000	5.125 %	\$ 15,115
3.00	60,000	3.00	8,000	5.125	15,908
3.00	62,000	3.00	8,000	5.125	16,743
3.00	64,000	3.00	9,000	5.125	17,622
3.00	66,000	3.00	9,000	5.125	18,546
3.00	67,000	3.00	9,000	5.125	19,519
3.00	69,000	3.00	9,000	5.125	20,544
3.00	72,000	3.00	10,000	5.125	21,622
3.00	74,000	3.00	10,000	5.125	22,756
3.00	76,000	3.00	10,000	5.125	23,950
3.00	78,000	3.00	11,000	5.125	25,207
	-		-	5.125	26,529
	-		-	5.125	27,921
	-		-	5.125	29,387
	-		-	5.125	30,929
	-		-	5.125	32,551
	-		-	5.125	34,259
	-		-	5.125	36,057
	-		-	5.125	37,949
	-		-	5.125	39,940
	-		-	5.125	42,036
	-		-	5.125	44,242
	-		-	5.125	46,563
	-		-	5.125	49,006
	-		-	5.125	51,578
	-		-	5.125	54,284
	-		-	5.125	57,132
	-		-	5.125	60,130
	-		-	5.125	63,285
		<u>-</u>	-	5.125	57,529
	\$746,000	_	\$ 101,000		\$1,038,839
		·-			



Independent Auditor's Report on Internal Control
over Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in Accordance
with Government Auditing Standards

To the Honorable Mayor and Members of the City Council:

We have audited the accompanying financial statements of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Earlham, Iowa, as of and for the year ended June 30, 2011, which collectively comprise the City's basic financial statements listed in the table of contents and have issued our report thereon dated November 3, 2011. Our report expressed unqualified opinions on the financial statements which were prepared in conformity with an other comprehensive basis of accounting. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in <u>Government Auditing Standards</u>, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurances all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed in the accompanying Schedule of Findings, we identified certain deficiencies in internal control over financial reporting we consider to be material weaknesses and other deficiencies we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility a material misstatement of the City of Earlham's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings as items A and C to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control which is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described the accompanying Schedule of Findings as item B to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Earlham's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under <u>Government Auditing Standards</u>. However, we noted certain immaterial instances of non-compliance or other matters that are described in the accompanying Schedule of Findings.

Comments involving statutory and other legal matters about the City's operations for the year ended June 30, 2011 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the City. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

The City of Earlham's responses to findings identified in our audit are described in the accompanying Schedule of Findings. While we have expressed our conclusions on the City's responses, we did not audit the City's responses and, accordingly, we express no opinion on them.

This report, a public record by law, is intended solely for the information and use of the officials, employees and citizens of the City of Earlham and other parties to whom the City of Earlham may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of the City of Earlham during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

Short a Company, CAA, P.L.C.

November 3, 2011

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Schedule of Findings

Year ended June 30, 2011

Findings Related to the Financial Statements:

INTERNAL CONTROL DEFICIENCIES:

- (A) Segregation of Duties One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. When duties are properly segregated, the activities of one employee act as a check on those of another. The cash receipts listing, bank deposits and the posting of cash receipts to the cash receipts journal, utility billing and collection, disbursement preparation and check signing, payroll and bank reconciliations are all done by the same person.
 - <u>Recommendation</u> We realize segregation of duties is difficult with a limited number of office employees. However, the City should review its control procedures to obtain the maximum internal control possible under the circumstances.
 - Response and Corrective Action Planned –The City continues to strive for maximum segregation of duties and will continue to review control procedures and job duties to this end.
 - <u>Conclusion</u> Response acknowledged. The City should segregate duties to the extent possible with existing personnel and utilize administrative personnel to provide additional control through review of financial transactions and reports.
- (B) Records of Accounts The City maintains separate bank accounts for the community center and library trust which pertain to those operations. The financial transactions and the resulting balances were not entirely included in the City's accounting records and were not included in the City's annual budget or monthly financial reports. However, those financial transactions and the resulting balances are included in these financial statements.
 - Recommendation Chapter 384.20 of the Code of Iowa states, in part, "A City shall keep accounts which show an accurate and detailed statement of all public funds collected, received, or expended for any City purpose." For better accountability, financial and budgetary control, the financial activity and balances of all City accounts should be included in the City's accounting records and annual budget and should be reported to the Council on a monthly basis.
 - <u>Response and Corrective Action Planned</u> The City Council will discuss these separate bank accounts with the Library and Community Center to rectify the situation.

<u>Conclusion</u> – Response accepted.

Schedule of Findings

Year ended June 30, 2011

(C) <u>Earlham Volunteer Fire and Rescue Association</u> – The Earlham Volunteer Fire and Rescue Association maintains records legally separate from the City of Earlham but reported in this audit report. One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. The cash receipts listing, bank deposits, disbursement preparation, check signing and bank reconciliations are all done by the same person.

<u>Recommendation</u> – We realize segregation of duties is difficult with a limited number of Association staff. However, the Association should review its control procedures to obtain the maximum internal control possible under the circumstances.

<u>Response</u> and Corrective Action Planned– The City Council will continue to discuss the need for segregation of duties with the Volunteer Fire and Rescue Association.

<u>Conclusion</u> – Response acknowledged. The Association should develop policies and procedures to ensure proper controls are in place.

INSTANCES OF NON-COMPLIANCE:

Short and Company, CPA performed a special investigation of the Earlham Volunteer Fire and Rescue Association for the period January 1, 2004 through April 30, 2011. The special investigation report, dated September 7, 2011, identified \$36,245.10 of improper disbursements and un-deposited collections, of which \$7,972.14 pertain to the year ended June 30, 2011.

Schedule of Findings

Year ended June 30, 2011

Findings Related to Required Statutory Reporting:

(1) <u>Certified Budget</u> – Disbursements during the year ended June 30, 2011 exceeded the amounts budgeted in the debt service function. In addition, disbursements in the capital projects function exceeded budget before the budget was amended May 9, 2011. Chapter 384.20 of the Code of Iowa states in part "Public monies may not be expended or encumbered except under an annual or continuing appropriation.

<u>Recommendation</u> – The budget should have been amended in accordance with Chapter 384.18 of the Code of Iowa before disbursements were allowed to exceed the budget.

<u>Response</u> – It is the intent of the City that all future budgets will be amended prior to exceeding the budgeted expenditures.

<u>Conclusion</u> – Response accepted.

- (2) <u>Questionable Disbursements</u> No disbursements we believe may not meet the requirements of public purpose as defined by an Attorney General's opinion dated April 25, 1979 were noted.
- (3) <u>Travel Expense</u> No disbursements of City money for travel expenses of spouses of City officials or employees were noted.
- (4) <u>Business Transactions</u> Business transactions between the City and City officials or employees are detailed as follows:

Name, Title, and Business Connection	Transaction Description	Amount
Mike Golightly, Council Member, Owner of Golightly Construction	Hauling and repairs	\$ 4,021
Jeff Lillie, Council Member, son of Randy Lillie of Randy Lillie Plumbing & Heating	Repairs	30,795

In accordance with Chapter 362.5(k) of the Code of Iowa, transactions with City officers less than \$2,500 in a fiscal year do not represent a conflict of interest. Another exemption to the conflict of interest provision is using the competitive bidding process to award contracts. It appears that a portion of the work with Randy Lillie Plumbing & Heating was awarded through competitive bidding, however, all other work exceeded the \$2,500 limitation.

<u>Recommendation</u> – The City should consult legal counsel to determine the disposition of this matter.

<u>Response</u> – The City Council will continue to approve all expenses and will obtain competitive quotes to ensure no conflict of interest when using companies associated with the mayor or council members. In November 2011 a notice was

Schedule of Findings

Year ended June 30, 2011

- posted and sent to the Earlham Advocate requesting closed bids for general services but none were received.
- <u>Conclusion</u> Response acknowledged. The City should ensure documentation is available to support that the council has considered all potential conflicts of interest and the efforts that were made to resolve all conflicts such as evidence of competitive quotes and bids.
- (5) <u>Bond Coverage</u> Surety bond coverage of City officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to ensure that the coverage is adequate for current operations.
- (6) <u>Council Minutes</u> No transactions were found that we believe should have been approved in the Council minutes but were not.
- (7) <u>Deposits and Investments</u> No instances of non-compliance with the deposit and investment provisions of 12B and 12C of the Code of Iowa and the City's investment policy were noted.
- (8) <u>Revenue Notes</u> No instances of non-compliance with the revenue note resolutions were noted.
- (9) <u>Financial Condition</u> The Road Use Tax, Capital Projects, and Debt Service Funds had deficit balances at June 30, 2011 of \$31,993, \$253,158 and \$62,933, respectively.
 - <u>Recommendation</u> The City should investigate alternatives to eliminate these deficits in order to return these funds to a sound financial position.
 - <u>Response</u> The City will continue to appropriate funds to eliminate the fund deficits in the Road Use Tax, Capital Projects, and Debt Services Funds.
 - <u>Conclusion</u> Response acknowledged. The City should periodically review fund activity to ensure funding sources are in place to adequately cover expenses.